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Client Quarterly Newsletter

Year End Recap 2008

It is no secret; so by now you know that 2008 was the worst year since 1937 which by itself was the worst year since the great depression. The S&P index was down 37% on the year, most of it coming in the last three months.

In august of 2007 I was interviewed on CNBC and said that the government needed to contain the financial crisis to the financial sector or we would have serious problems. Not only did they not contain the crisis, they exacerbated it.

After initial halting efforts to shore up the economy, the Federal Reserve and Ben Bernanke realized the problem was bigger than they thought. (This was a theme that was reiterated throughout the year: the problem was bigger than we thought). Efforts at the margins, and new emergency funds set up by the fed, as well as interest rate cuts, failed to stem the tide, and problems worsened. At the end of March Bear Stearns failed and was sold to JP Morgan for pennies on the dollar. Rather than the end, this turned out to be just the beginning. Banks began to fail, and indeed one of the largest investment banks, Lehman Brothers failed which sent ripples throughout the world. The government quickly converted Morgan Stanley and Goldman Sachs into banks so they could get federal bailout money, and extended over $135 Billion to AIG to avoid further disaster.

The rest of the world began to feel the pain. Banks failed, and in some cases countries came to the brink. Commodity prices went into freefall, and oil went from $145.00 to $35.00

President Bush announced the he was taking "Decisive action", but the House Republicans defeated the administration's $700 Billion rescue package.

We also elected a new President, federal funds rate dropped to .25%, and the biggest financial fraud in history was unearthed. (No, it was not the government or Social security).

Through it all, at Rutherford we tried to maintain a defensive posture for our portfolios, mindful that our job as portfolio managers is to manage your investments, not your cash. Still we maintained high levels of cash and cash substitutes. We brought our "money home" from

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overseas, and the investments we had were in stocks we believed were solid for the long term. Even so, we lost money. However, it was a year when General Motors was down 86.9%, GE down 53.9%, and Citigroup down 75.9%, so relatively speaking we did better.

Perhaps you have met someone who saw "it" coming and got out of the market. That person is probably also dating Julia Roberts. Neither Buffet, nor Gates, nor Ballmer nor Jobs nor many other serious investors got out of the market. It simply was much worse than expected.

Going forward, we see a great deal of uncertainty. The fall of manufacturing and retailing in the fall has yet to have its complete impact on the economy. The market is another matter. The market looks to the future about 6-9 months; what we have seen is the market inching up in the face of some very bad news. We are now over 20% up from our low. While I do believe that the market faces another sharp downturn in late spring, I believe that by fall, we should see a recovery, and by year end be about where we started the year. Of course, I can be wrong, and the market could surprise to the upside or the downside. I also expect more external events like Gaza or Russia turning off the gas to Ukraine as our new President gets his sea legs. But for long term investors, this should be a good time to invest.

As always we appreciate the opportunity to manage your funds, and look forward to any questions that you may have.

William D. Rutherford, President
Rutherford Investment Management LLC.